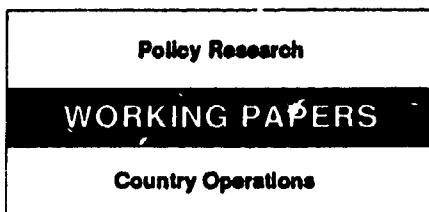


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Who Would Vote for Inflation in Brazil?

An Integrated Framework Approach to Inflation and Income Distribution

**Cheikh Kane
and
Jacques Morisset**

Are Brazil's delays in adopting a stabilization program related to the finding that Brazil's high inflation hurts the lower and middle classes far more than the rich, who insulate themselves from its effects by taking advantage of high real interest rates on demand deposits?

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This paper — a product of the Latin America and the Caribbean, Country Department I — is part of a larger effort in the department to understand the social dimensions of inflation. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Tania Hollestelle, room 17-041, extension 30968 (September 1993, 29 pages).

Most studies of how inflation affects income distribution focus only on wages or the inflation tax. Kane and Morisett argue that this approach could be misleading as it ignores important channels through which inflation affects income distribution.

The authors present an integrated framework that combines interest-bearing assets with labor income and cash holdings. This allows them to describe clearly the conditions under which inflation will create gainers and losers.

They apply the model to Brazil, which is a prime candidate for this exercise because its economy combines skewed income distribution and high inflation. They show that in Brazil inflation helped worsen income distribution in the 1980s. Their major findings are as follows:

- In 1980-89, the inflation-induced income loss for the lowest quintile in Brazil was an

estimated 19 percent a year, of which 16 percent is attributable to the erosion of real wages and the rest to the inflation tax.

- During the same period, Brazil's middle class, which lost close to 30 percent of its annual income, was devastated because of its limited access to indexed assets.

- But the richest quintile managed to insulate itself from inflation by taking advantage of high real interest on demand deposits — without losing from reduced labor income. Had real assets and subsidized credit been considered in the analysis, the regressive effects of inflation would probably have been even worse, say Kane and Morisett.

This raises a question: Do these findings about the distributional effects of inflation help explain Brazil's delays in adopting a stabilization program?

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